Key Wealth Institute

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Key Questions: Investing Before Lift Off — What Should Investors Know About Private Markets and the Next IPO Cycle?

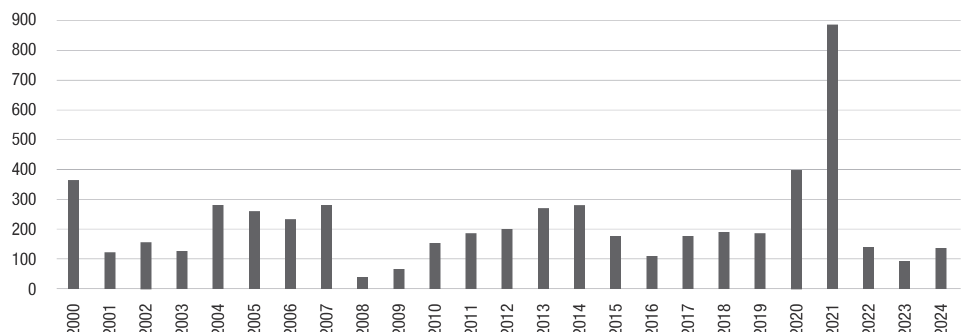
Sean Poe, Director of Investment Research

With the investor enthusiasm for one (and possibly more) high-profile private companies rumored to be considering filing an initial public offering IPO this year, there is palpable hope that the IPO market may finally be reopening after several years of tepid activity. Investors are likely wondering what this notable market event could mean for their portfolios and, more specifically, how they can capitalize on the opportunity set. In this article, we discuss the market dynamics that led to this point, as well as the opportunities and considerations for investors looking for IPO market exposure.

Going public

Traditionally, going public through an IPO has been the ultimate goal for many companies. Whether a venture-backed business proceeding through rounds of funding or a family-owned business growing into a large company, an IPO has been effectively the only way to convert a successful business into liquid, transferable wealth for founders, employees, and investors. For both private equity and venture capital firms alike, the IPO served as an important realization mechanism to return value to their investors. As the broader private equity complex grew, so did the aggregate value of the IPO market. By 2021, aided by low interest rates and accommodative regulations, the number of U.S. IPOs reached 886 issuances in 2021, representing an aggregate value of more than $300 billion.

Number of IPOs by U.S. Issuers



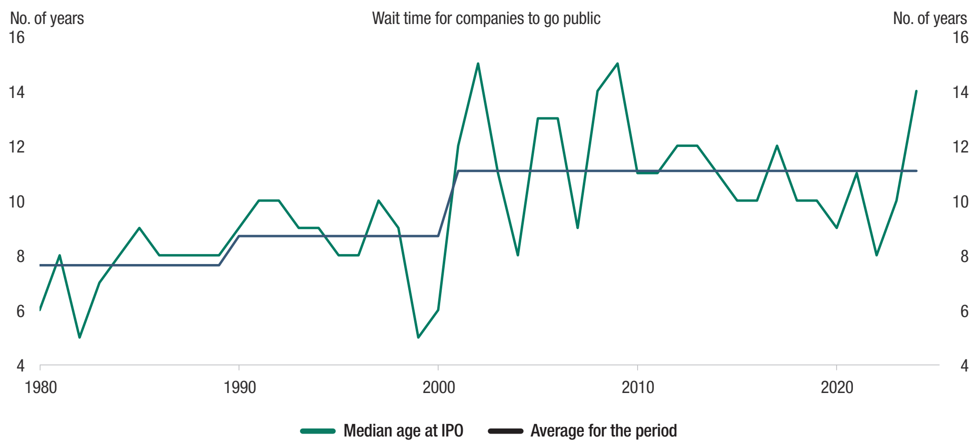
Source: SEC.gov

Closing the IPO window

Post-2021, several forces combined to effectively shut the IPO window. Rising interest rates during 2022 and 2023 were the most notable culprit; as rates rose, markets applied sharper valuation criteria to unproven companies, resulting in public valuations falling below the price that private markets were holding for their portfolio companies. Additionally, the cost of going public, both in terms of transaction expenses (often more than 6%) and increasingly high regulatory burdens associated with being a public company, and elevated market volatility contributed to a slower IPO market.

At the same time, private markets continued to mature. Companies that would have previously sought an IPO simply stayed private, where they could continue to access funding without taking on the costs associated with going public. This led to an interesting phenomenon, wherein the median company age at IPO reached 14 years by 2024, a notable increase from historical averages of approximately 8 to 10 years.

Companies are waiting longer to go public



Source: Apollo Global Management

Why the IPO window may be reopening

Through 2025 and into early 2026, IPO market conditions appear more constructive. Equity market volatility has moderated, inflation has eased, and expectations for monetary policy normalization (i.e., interest rates) have improved.

Importantly, the reopening of the IPO window is likely to be selective. Rather than a broad-based resurgence similar to 2021, IPO activity is expected to favor established companies with clear paths to profitability and resilient business models. There remains a strong backlog of IPO candidates that have stayed private, awaiting the opportunity to generate liquidity.

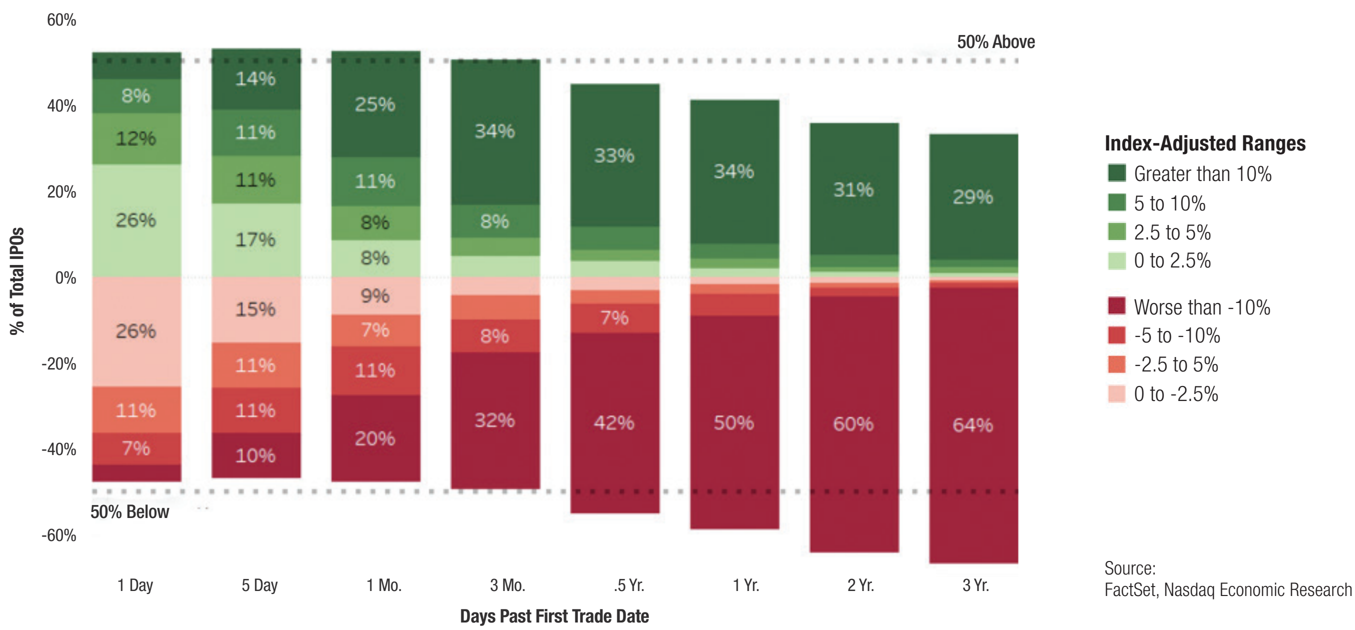
The challenge of IPO investing

As conditions improve, market commentators are increasingly excited about the chance to see several newsworthy companies potentially go public. However, headlines do not necessarily equal a successful investment opportunity. From an investor's perspective, participating in IPOs has been an extremely volatile way to generate returns, if one can even get access. IPO shares are allocated through a complex offering process facilitated by investment banks, which are incentivized to allocate shares to large, institutional investors at high valuations.

If you are able to access IPO shares, the resulting investment returns are quite varied. There is often an "IPO pop" on the first day of trading; according to NASDAQ research, the average return on the first trading day was 18.9% from 1980 through 2023.[1] However, early investors are often locked up for 90 to 180 days, meaning they can't take advantage of the quick return, and longer-term data on IPO returns is less encouraging. Looking out over 3+ months, the average IPO return performs worse than its relevant index.

Distribution of IPO Returns Post-IPO

Note: Returns indexed to closing price of first trade date. Small cap companies indexed relative to Russell 2000; Large cap companies indexed relative to the S&P 500. Chart includes traditional IPOs from 2010 through 2020.



Accessing growth through private markets

While the IPO event draws the headlines, the data suggests that better returns to investors may be found before filing for an IPO, whether via private equity or venture capital funds. These funds will own privately held companies, sometimes for multiple financing rounds, allowing investors to benefit from the full path from a privately held company through IPO.

Of course, private investing involves incremental complexity in the form of investor suitability, cash and tax management, and portfolio construction. A financial advisor can advise investors on the suitability of building a private investment allocation.

As the IPO window gradually reopens, investors may benefit less from timing public listings and more from structuring portfolios that access growth earlier — where much of today's innovation and value creation already occurs — and consider incorporating private equity investments within their portfolios.

For more information, please contact your advisor.

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1 Getting a Slice: How IPO Shares Are Priced and Allotted | Charles Schwab

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